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In the

Supreme Court of the United States

OCTOBER TERM, 1970

No. 713

C. W. PAYTON AND BESSIE JOYCE PAYTON,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR WRIT OF CERTIORARI
To the United States Court of Appeals
For The Fifth Circuit

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No.

C. W. PAYTON AND BESSIE JOYCE PAYTON,
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v.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR WRIT OF CERTIORARI
To the United States Court of Appeals
For The Fifth Circuit

Petitioners, C. W. Payton and Bessie Joyce Payton, respectfully pray that a writ of certiorari issue to review a judgment of the United States Court of Appeals for the Fifth Circuit entered May 5, 1970, reversing and remanding the judgment of the United States District Court for the Eastern District of Texas, with instructions to the District

Court to enter judgment n.o.v. in favor of the Respondent United States.

OPINION BELOW

The opinion of the Court of Appeals is not reported but is reproduced at Page A-1 of the Appendix hereof. A motion for rehearing was filed and was overruled by the Court of Appeals on June 24, 1970, and is reproduced at Page B-1 of the Appendix hereof. The judgment of the District Court, entered without opinion, is reproduced at Page C-1 of the Appendix hereof.

JURISDICTION

The judgment of the Court of Appeals was entered on May 5, 1970. Jurisdiction is conferred upon this Court by 28 U.S.C.A., Section 1254(1).

QUESTIONS PRESENTED

The questions presented for decision in this case are:

(1) Was the evidence introduced before the trial court sufficient to establish that Payton Optical Company was a bona fide family partnership for tax purposes?

(2) Did the Court of Appeals err in reversing and remanding the judgment of the trial court with instructions to enter judgment n.o.v. in favor of the United States?

(3) Is a litigant entitled to an oral argument in the Court of Appeals before a judgment based upon a jury verdict can be reversed.

STATUTES INVOLVED

The questions presented involve the following statutes:

26 U.S.C.A. § 704(e) (1) and (2):

> (1) Recognition of interest created by purchase or gift. — A person shall be recognized as a partner for purposes of this subtitle if he owns a capital interest in a partnership in which capital is a material income-producing factor, whether or not such interest was derived by purchase or gift from any other person.
>
> (2) Distributive share of donee includible in gross income. — In the case of any partnership interest created by gift, the distributive share of the donee under the partnership agreement shall be includible in his gross income, except to the extent that such share is determinated without allowance of reasonable compensation for services rendered to the partnership by the donor, and except to the extent that the portion of such share attributable to donated capital is proportionately greater than the share of the donor attributable to the donor's capital. The distributive share of a partner in the earnings of the partnership shall not be diminished because of absence due to military service.

STATEMENT OF THE CASE

Petitioner and taxpayer C. W. Payton is a medical doctor, limiting his practice to that of being an ophthalmologist, which practice is limited to the treatment and surgery concerning eye diseases and defects.

On June 1, 1961, Petitioner and his wife created five separate trusts for the benefit of their minor daughters and conveyed to them certain properties not in controversy in this litigation. These trust instruments were in standard

form and complied with Texas law and have never been attacked by the Respondent in any manner whatsoever as being insufficient at law to transfer such property to such minor daughters.

In addition to being an ophthalmologist, the Petitioner owned a sole proprietorship known as the Payton Optical Company. An optical company does not treat a person for eye diseases or eye defects, but the evidence shows that an optical company is similar to a drug store, in that a patient can carry a prescription for glasses which would correct his eye defects and these prescriptions are filled by the optical company, no matter from what doctor or optometrist such prescription might come.

On November 24, 1962, Petitioner and his wife made a gift by bill of sale dated November 24, 1962, of a twelve per cent interest in the Payton Optical Company to each of the five trusts which he had created for his minor daughters, conveying by such bill of sale, sixty per cent of the assets owned by Payton Optical Company. Thereafter, a partnership agreement which complied with Texas law and which has never been set aside in any manner whatsoever, was executed and thereafter Petitioner owned forty per cent of the Payton Optical Company and the five trusts owned a total of sixty per cent. On March 8, 1963, Petitioner and his wife created the sixth trust for the benefit of their minor son with the same provisions as the trusts which had been created for the daughters and in such trust itself, rather than having a separate bill of sale, conveyancing language was

contained in the trust; conveying to the trust for the minor son, a fifteen per cent interest of the Payton Optical Company. An amended partnership agreement was executed on March 8, 1963, adding the trust for the minor son as a partner. From that day forward, Taxpayer Payton owned twenty-five percent of Payton Optical Company and the six trusts owned a total of seventy-five per cent of Payton Optical Company and taxpayer reported twenty-five per cent of the net income of the partnership.

No contention has ever been made by the State authorities or the Respondent in this case, that the trust instruments themselves, nor the bill of sale nor the articles of partnership or amended articles of partnership were not sufficient under the common law, to make the six trusts partners in the operations of Payton Optical Company, along with Petitioner C. W. Payton, but the Respondent does contend that for tax purposes the Payton Optical Company was not a bona fide partnership.

The evidence showed that Taxpayer Payton performed very little actual services for the partnership; that separate bank accounts were maintained after the creation of the trusts for the minor children; that billings to the creditors of Payton Optical Company and the individual medical practice of Taxpayer Payton were always kept separate; that an employer identification number was obtained for the partnership; that the partnership furnished its own W-2 Forms; that separate payroll returns were made for the partnership; that the suppliers were informed that they should be careful to bill Payton Optical Company for inven-

tories purchased by the partnership as compared to individual purchases made by Dr. Payton in his individual medical practice; that the actual operation of the partnership was by a paid employer and daily records were maintained to show that the optical company received the monies to which it should report as income.

After hearing the evidence, the trial court submitted two special interrogatories to the jury, with such interrogatories and their answers being:

> Interrogatory No. 1: Do you find from a preponderance of the evidence that the maintenance and operation of the partnership between plaintiffs Dr. and Mrs. C. W. Payton and the six trusts for their minor children was in good faith and that the capital to be contributed by each of the partners was of such value that each of such partners should participate in his proportionate part of the profits?
>
> Answer: "Yes" or "No."
>
> Answer: Yes.
>
> Interrogatory No. 2: What sum of money, if any, do you find would be a reasonable compensation for the services of C. W. Payton, M.D., to the partnership during the entire year of 1963?
>
> Answer: $1300.00.

ARGUMENT

THE EVIDENCE IS SUFFICIENT TO ESTABLISH THAT PAYTON OPTICAL COMPANY WAS A BONA FIDE FAMILY PARTNERSHIP FOR TAX PURPOSES

In construing the bona fides of a family partnership, the test for many years has been that as is set forth in

Commissioner v. Culbertson, 1949, 337 U.S. 733, 69 S. Ct. 1210, 93 L. Ed. 1459. This case stated:

> "The question is not whether the services or capital contributed by a partner are of sufficient importance to meet some objective standard supposedly established by the Tower case, but, whether, considering all the facts — the agreement, the conduct of the parties in execution of its provisions, their statements, the testimony of disinterested persons, the relationship of the parties, their respective abilities and capital contributions, the actual control of income and the purposes for which it is used, and any other facts throwing light on their true intent — the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise.
>
> If, upon a consideration of all the facts, it is found that the partners joined together in good faith to conduct a business, having agreed that the services or capital to be contributed presently by each is of such value to the partnership that the contributor should participate in the distribution of profits, that is sufficient."

As can readily be seen, special interrogatory number 1 was couched in the precise terms of Culbertson.

That part of the Internal Revenue Code providing for family partnerships is 26 U.S.C.A. 704(e)(1) and (2) set forth herein. The reason that such statute was adopted was due to the fact that the courts could not follow the principles set forth in the case law. In adopting the forerunner of 26 U.S.C.A. 704(e)(1) and (2), which was a part of the Revenue Act of 1951, the Senate Finance Com-

mittee Report on HR4473, Proposed Revenue Act of 1951, stated as a part of its report:

> "Your Committee's Amendment makes it clear that, however the owner of a partnership interest may have acquired such interest, the income is taxable to the owner, if he is the real owner. *If the ownership is real, it does not matter what motivated the transfer to him or whether the business benefited from the interest of the new partner.* * * * It, therefore is, and remains true that the acid test for determining the question of the reality and validity vel non of a family partnership is to be found in the answer to the question: Was the arrangement, real, honest and bona fide, so that all the ordinary incidents and effects of an agreement of partnership flow, each partner bound for the losses, each sharing in the profits, in accordance with his agreement? *If the answer is yes, whatever may be found to be the intent or results taxwise, there was a partnership.*" (Emphasis ours)

From both of such quotations, it can readily be seen that the evidence in this cause was sufficient to establish a bona fide family partnership for tax purposes. The articles of partnership were real and complied with the applicable partnership law in creating a partnership, and the partnership agreement provided that each partner was bound for the losses and that each was to share in the profits.

As to this entire controversy, the Respondent has maintained and the Court of Appeals followed its argument, that since the taxpayer Payton was a medical doctor and could send patients to the partnership optical company to have such patients' prescriptions for glasses filled, then the capital contributed to the partnership Payton Optical

Company was not a material income producing factor. The evidence showed that when the bill of sale was executed and the gift was made to the taxpayers' minor children, the company had non-inventory assets of $752.00 and an inventory of $2,000.00. Of course, the non-inventory assets were depreciated assets at that value and this does not mean that such non-inventory assets had far more use than a value of $752.00. In fact, the Respondent never realized, but it is true that if someone other than the taxpayer and the trusts for the six minor children had owned the exact non-inventory assets and inventory assets, that the partnership owned, but yet did the same business, it would have made the same profits that the partnership made, and there can be no doubt but what no question would ever have been raised about such income. The equipment of a non-inventory nature that was owned by the partnership, was special grinding equipment and machinery with which to fit glasses. A business such as the Payton Optical Company could not have been maintained without such machinery. If someone other than the Paytons had been partners in the same type of business with the same type of equipment, then it would have had a going concern and if it had had the same amount of gross income and the same amount of expenses, then the income would have been the same. Thus, when looked upon in that light, there can be no doubt whatsoever, but what capital was a material income-producing factor in the Payton Optical Company. The evidence produced in this cause falls squarely within the principle enunciated in *Seabrook v. Commissioner of In-*

ternal Revenue, 5th Cir., 196 F. 2d 322, wherein that case stated:

> "This was not a mere temporary reallocation of income within the family group; nor did the income continue to be used for the same business and family purpose as before the formation of the partnership. There was a change in the economic relationship of the father and the children with respect to the income."

Other cases which would sustain the finding of the trial court are *Estate of Dorsey, et al. v. Commissioner of Internal Revenue*, 5th Cir., 214 F. 2d 294; *Cooke v. Commissioner of Internal Revenue*, 10 Cir., 203 F. 2d 258; *Britt's Estate v. Commissioner of Internal Revenue*, 5 Cir., 190 F. 2d 946; *Marcus, et al. v. Commissioner of Internal Revenue*, 5 Cir., 201 F. 2d 850; *Tomlinson, et ux. v. Commissioner of Internal Revenue*, 5 Cir., 199 F. 2d 674; and *Stanback v. C.I.R.*, 4 Cir., 271 F. 2d 514.

It can not be argued that the Payton Optical Company was a personal service matter because the jury finding was that a reasonable compensation for the small duties that Dr. Payton performed would have been $1300.00 per annum. As to Dr. Payton's opportunity to refer business to the partnership, that would not make it a void partnership for tax purposes because of the reasons set forth in *Robert P. Crowley, et ux v. Commissioner of Internal Revenue*, 34 T.C. 333.

Even though all of the above cited cases are the law and even though the evidence is as outlined in the statement herein, the Court of Appeals nevertheless held, in spite of

the fact that a jury of twelve people did pass on the two interrogatories set out above:

> "The undisputed facts and inferences permissible therefrom point so strongly and conclusively against the existence of a bona fide family partnership that reasonable men could not arrive at a contrary verdict."

THE COURT OF APPEALS, BEFORE REMANDING THE DISTRICT COURT'S JUDGMENT, SHOULD HAVE ALLOWED ORAL ARGUMENT BY PETITIONER

Even though the Petitioner can cite no cases that it was error to deny argument, it would certainly seem to the Petitioner that if his constitutional rights granted to him by the Constitution of the United States are to be protected, then before a jury verdict rendered by twelve American citizens is to be reversed and remanded with instructions to the District Court to enter judgment n.o.v. in favor of the United States, that the Petitioners should have at least been allowed to appear before the Court of Appeals and present their argument through their attorney in person, rather than place the same on the summary calendar.

CONCLUSION

The judgment of the Court of Appeals eliminates rights given to the Petitioners by the Internal Revenue Code. The facts were sufficient to establish and to maintain the jury's verdict that Payton Optical Company was a bona fide family partnership for tax purposes.

Petitioners respectfully submit that the judgment of the Court of Appeals is manifestly in error and prays that a

writ of certiorari issue in this cause to review such decision and that thereafter the decision of the Fifth Circuit Court of Appeals be reversed and the decision of the District Court for the Eastern District of Texas be affirmed.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that service of this brief has been made on opposing counsel by mailing the same on this the 16 day of September, 1970, in an envelope, with postage prepaid, properly addressed to him as follows:

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IN THE

United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 28431
Summary Calendar

C. W. PAYTON and BESSIE JOYCE PAYTON,
Plaintiffs-Appellees,

v.

UNITED STATES OF AMERICA,
Defendant-Appellant.

Appeal from the United States District Court for the Eastern District of Texas

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(May 5, 1970)

Before WISDOM, COLEMAN and SIMPSON, Circuit Judges.

SIMPSON, Circuit Judge: Pursuant to Rule 18 of the Rules of this Court, we have concluded on the merits that this case is of such character as not to justify oral argument and have directed the Clerk to place the case on the Summary Calendar and to notify the parties in writing. See *Murphy v. Houma Well Service*, 5 Cir. 1969, 409 F. 2d 804, Part I; and *Huth v. Southern Pacific Company*, 5 Cir. 1969, 417 F. 2d 526, Part I.

The central question presented by the government's appeal in this tax refund case is whether or not the district court erred in denying the appellant's motion for judgment n.o.v. following verdict for the taxpayer. The ground urged is that the evidence clearly shows that the Payton Optical Company was not for tax purposes a family partnership under the test articulated in *Commissioner v. Culbertson*, 1949, 337 U.S. 733, 69 S. Ct. 1210, 93 L. Ed. 1459. We agree with appellant and reverse and remand for the entry of judgment n.o.v. In view of this disposition we pretermit discussion of the subordinate question raised, the exclusion of evidence that the partnership did not comply with the Texas assumed name statute.

The controlling facts are not in dispute. C. W. Payton (Taxpayer) was a practicing ophthalmologist in Longview, Texas. Taxpayer would examine patients, test for eye disease and refraction, and where indicated, give the patient a prescription for eyeglass lenses. He also operated as a sole proprietorship the Payton Optical Company, which filled eyeglass prescriptions. The patient could have the Taxpayer's prescriptions filled wherever he wished, but normally the company filled them. There were some referrals from elsewhere, but the majority of the company's business came from the Taxpayer's practice of medicine.

On June 1, 1961, Taxpayer and his wife created five trusts for the benefit of their five minor daughters. Each trust contained the following pertinent provisions: (1) that certain properties (not herein controversy) were absolutely and irrevocably transferred to the trust; (2) that the trust became effective June 1, 1961; (3) that the gifts and the trust were irrevocable until the date upon which its beneficiary reached the age of 21; (4) that upon the date of termination of the trust, or at such earlier date should the beneficiary die prior to reaching the age of 21, the corpus of the trust would revert to the settlors; (5) that the sole trustee was Taxpayer; and (6) that as long as Taxpayer served as trustee, no loan was to be made between the trust and the settlor, unless adequate consideration and

security was given and unless the terms required repayment thereof within the same taxable year. These five trusts were duly recorded in the proper county court.

On November 24, 1962, Taxpayer and his wife *purportedly* made a gift of a 12 per cent interest in the Payton Optical Company to each of the five trusts. On the same day a partnership was *attempted to be formed*. Taxpayer held a 40 per cent interest, and each of the five trusts held a 12 per cent interest. Under this agreement the partnership was to be known as the Payton Optical Company, the managing partner was to be Taxpayer, and the partnership was to commence September 1, 1962, and terminate on May 24, 1972.

On March 8, 1963, Taxpayer and his wife created an additional trust for the benefit of their minor son, with the same provisions as the trusts created for the daughters, except that the interest in the company conveyed to the trust was a 15 per cent interest. On the same date an amended partnership agreement was entered into which added as a partner the trust created for Taxpayer's son, so that Taxpayer was left with a 25 per cent interest in the partnership.

Neither the partnership agreement, amended partnership agreement, nor the trust for the minor son, was recorded.

After the effective date of the partnership agreements, the lens dispensing business, except for accounting procedures, was operated precisely the same as prior to the transfer.

Prior to the partnership agreement the only entrance to the company's premises was through a door from the outside which led directly into the waiting room for Taxpayer's medical practice, and the use of this entrance continued for several years after such agreement was executed.

The lease for the building in which both businesses were conducted was solely in the name of Taxpayer. After the trust and partnership agreements, a new lease was entered into securing the use of a different part of the building for

the company and that lease was also in Taxpayer's name individually with no mention of a partnership, or of the company. After this new portion was leased, there was a separate outside entrance for the optical company. However, there was no sign or other indication that the building, under either lease, was occupied by the company. No separate telephone was maintained for the company for over a year after execution of the agreement. The name of the company did not appear in the yellow pages of the local telephone directory for the year 1963 or any other year.

Patients were billed for eyeglasses by Taxpayer individually, and not by the company, and sometimes the charges for examination, lenses and frames were lumped together without designation as to the services or goods involved. Patients would pay for these services with only one check made payable to Taxpayer individually, and never to the company, even if the services performed were solely those of the company, and the patients were never made aware that they were dealing with anything but a sole proprietorship. Taxpayer would deposit these sums in the medical practice account.

Creditors billed the company separately but were never notified of the existence of a partnership. Expenses were sometimes paid from Taxpayer's personal account, and generally at the end of the month, and certainly at the end of each year, the income and expenses of both the medical practice and the optical dispensing business were compared with the daily ledger sheets to ascertain if any adjustments were necessary and, if so, adjustments and allocations were made and settled by the issuance of checks.

Only one employee, the manager, was told of the existence of the partnership and that he was working for essentially two different businesses. *Withholding and social security taxes were reported under Dr. Payton's individual I.D. number.*

None of Taxpayer's children performed services for the company or had anything to do with its operation, nor was it contemplated that they would because of their age.

Taxpayer directed the overall policy of the company and had the final say in hiring and firing personnel.

At the time of the November, 1962, gifts to the children, the company had noninventory assets of $752 and inventory of $2,000. In 1963 the company had gross sales income of $86,634.03 generated from resale of goods purchased for $44,659.18. There were beginning and ending inventories of $2,000 and there were other assets having a depreciated value of only $714.42. Withdrawals from the partnership in 1963 left a negative equity in the partnership for each of the partners.

On December 29, 1965, Taxpayer executed a deed of trust note for $3,000 to each of the six trusts, promising to repay said amount plus six per cent interest on or before one year from said date and giving as security certain listed properties. On the same date, Taxpayer executed deeds of trust running to each of the six trusts and listing such properties. Neither the deed of trust notes nor the deeds of trust were recorded.

A check in the amount of $3,000 from each trust, payable to Taxpayer and dated December 31, 1965, was deposited on such date into the personal account of Taxpayer and paid January 3, 1966. Prior to December 29, 1966, Taxpayer had paid to each trust the sum of $356.38 in repayment of the loan. Checks dated December 29, 1966, for the remainder of the loan plus interest were made payable to each of the trusts, cashed January 2, 1967, and paid on the same date.

On or before April 15, 1964, plaintiffs-appellees, Taxpayer and his wife, filed their federal income tax return for the year 1963, and paid the tax due shown thereon of $21,011.28. Upon audit by the Internal Revenue Service, deficiencies for the year 1963 were assessed in the amount of $15,546.14 in income tax and $537.94 in interest. The total deficiencies plus interest, totaling $16,084.08, were paid by Taxpayer and timely claim for refund of $15,546.14 for taxes for 1963 was filed on April 15, 1967. The refund suit was filed in the court

below in March 1968. On May 6, 1969, the plaintiffs-appellees, after jury verdict, were granted judgment for a tax refund for 1963 for $12,856.99 plus interest.

The test for determining the validity of family partnerships for income tax purposes was declared by the Supreme Court in *Commissioner v. Culbertson*, supra:

> "The question is not whether the services or capital contributed by a partner are of sufficient importance to meet some objective standard supposedly established by the *Tower* case, but, whether, *considering all the facts* —the agreement, the conduct of the parties in execution of its provisions, their statements, the testimony of disinterested persons, the relationship of the parties, their respective abilities and capital contributions, the actual control of income and the purposes for which it is used, and any other facts throwing light on their *true intent* — the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise." (Emphasis added)

The facts in this case required the entry of judgment n.o.v. when weighed upon *Culbertson* scales. It was error for the district court to deny the motion for judgment n.o.v.

The undisputed facts and inferences permissible therefrom point so strongly and conclusively against the existence of a bona fide family partnership that reasonable men could not arrive at a contrary verdict. *The Boeing Company v. Shipman*, 5 Cir. 1969, 411 F. 2d 365, 374.

Prior to creation of the trusts and the attempted creation of the family partnership Dr. Payton was conducting a profitable and established optical dispensing business side-by-side with his professional practice as an ophthalmologist. The business of the former was largely generated by the latter. Capital being an insignificant aspect of the optical dispensing business, after the partnership was formed the optical dispensing business operated exactly as before, unchanged as to location, management, staff, the manner in

which it was held out and known to the public, the source of its business and income, and with no services or material amount of capital being provided by the trusts or the beneficiaries thereof. It is clear that a bona fide partnership never came into being. The partnership agreement had no substance; it was a pretense only, with intended beneficial results to Dr. Payton's tax burden without a concomitant change in his control over income being the only valid reason for its existence. The "economic realities" of this case require that the income from the alleged partnership be taxed to the appellees, Dr. Payton and his wife.[1]

This case is REVERSED and REMANDED with instructions to the district court to enter judgment n.o.v. in favor of the United States.

---

[1] Cf. *Helvering v. Clifford*, 1940, 309 U.S. 331, 60 S. Ct. 554, 84 L. Ed. 788; *C.I.R. v. Tower*, 1945, 327 U.S. 280, 66 S. Ct. 532, 90 L. Ed. 670; *Chace v. United States*, 5 Cir. 1970, ___ F. 2d ___ [No. 28601, Feb. 17, 1970]; *Furman v. C.I.R.*, 5 Cir. 1967, 381 F. 2d 22.

B-1

United States Court of Appeals

FIFTH CIRCUIT
OFFICE OF THE CLERK

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June 24, 1970

TO ALL PARTIES LISTED BELOW

Re: No. 28431 — Payton v. U. S. A.

Gentleman:

You are hereby advised that the Court has today entered an order denying the Petition( ) for Rehearing in the above case. No opinion was rendered in connection therewith. See Rule 41, Federal Rules of Appellate Procedure for issuance and stay of the mandate.

Very truly yours,

EDWARD W. WADSWORTH
Clerk

By .....
Deputy Clerk

cc:
Hon. Johnnie M. Walters
Mr. Jerry A. Wells
U. S. Attorney, Tyler, Texas
Mr. John M. Smith

C-1

IN THE

United States District Court

FOR THE EASTERN DISTRICT OF TEXAS
TYLER DIVISION

Civil Action No. 4856

C. W. AND BESSIE JOYCE PAYTON,

Plaintiffs,

v.

UNITED STATES OF AMERICA,

Defendant.

JUDGMENT

This cause having been tried to the Court and jury on April 2, 1969, and the Court having submitted issues to the jury and the jury having answered as follows:

INTERROGATORY NO. 1:

"Do you find from a preponderance of the evidence that the maintenance and operation of the partnership between Plaintiffs Dr. and Mrs. C. W. Payton and the six trusts for their minor children was in good faith and that the capital to be contributed by each of the partners was of such value that each of such partners should participate in his proportionate part of the profits?

Answer: Yes

INTERROGATORY NO. 2:

What sum of money, if any, do you find would be a reasonable compensation for the services of C. W. Pay-

ton, M.D., to the partnership during the entire year of 1963?

Answer: $1,300

We, the Jury, having answered the foregoing Interrogatories return same as our Verdict.

/s DAVID C. MORGAN
Foreman

it is therefore

ORDERED, ADJUDGED AND DECREED that plaintiffs have and recover of and from the defendant, United States of America, the sum of $12,856.99, together with statutory interest thereon, and for costs in the amount taxed by the Clerk of this Court.

Dated this 6th day of May, 1969.

/s/ Joe J. Fisher
United States District Judge

APPROVED AS TO FORM:

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SUPREME COURT, U. S.

No. 712

Supreme Court, U.S.
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In the Supreme Court of the United States

OCTOBER TERM, 1970

C. W. PAYTON AND BESSIE JOYCE PAYTON,
PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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In the Supreme Court of the United States

OCTOBER TERM, 1970

No. 713

C. W. PAYTON AND BESSIE JOYCE PAYTON,
PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The district court did not render an opinion. The opinion of the court of appeals (Pet. App. A1-A7) is not yet reported.

JURISDICTION

The judgment of the court of appeals was entered on May 5, 1970. A petition for rehearing was denied on June 24, 1970 (Pet. App. B1). The petition for a

writ of certiorari was filed on September 17, 1970. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether the court of appeals correctly held that Payton Optical Company was not a family partnership for income tax purposes and, therefore, that its income could not be split among its partners, but was taxable in full to petitioner.

2. Whether petitioner was denied his constitutional rights when the court of appeals decided this cause on the basis of the briefs and the record without oral argument.

STATUTE AND RULES INVOLVED

The statute and rules involved are set forth in the Appendix, *infra*, pp. 9-11.

STATEMENT

Petitioner [1] was an ophthalmologist in the practice of examining patients for eye defects and prescribing eye-glass lenses where necessary. In addition, he was the sole proprietor of the Payton Optical Company (hereinafter referred to as the proprietorship), which filled the majority of his prescriptions and was located in the same building as his office. On June 1, 1961, petitioner created five irrevocable

[1] References to "petitioner" are to C. W. Payton. Bessie Joyce Payton is a party to these proceedings solely because of the filing of a joint income tax return.

trusts—one for each of his minor daughters—to which certain property was transferred with the provision that petitioner would be trustee and that the trusts would terminate when the respective beneficiaries reached age 21, or upon their death, if earlier, with the trust corpus then reverting to petitioner. (Pet. App. A2.)

On November 24, 1962, petitioner purportedly gave a 12 percent interest in the proprietorship to each of the five trusts. That same day, an alleged partnership was formed to carry on the optical dispensing business formerly carried on by the proprietorship. Petitioner had a 40 percent interest in this partnership and was the managing partner, while each of the five trusts held a 12 percent interest. The partnership was to commence on September 1, 1962, and terminate on May 24, 1972. On March 8, 1963, petitioner created an additional trust for the benefit of his minor son, similar to the earlier trusts, and conveyed a 15 percent interest in the partnership to this trust. The partnership agreement was amended to reflect this change. After the effective date of the partnership agreement, the lens dispensing business of the partnership, except for accounting procedures, was operated in precisely the same manner as prior to the transfers. Its location, management, staff, the manner in which it was held out and known to the public, and the source of its business and income remained unchanged. No services or material amount of capital were provided by the trusts or their beneficiaries. (Pet. App. A3, A6-A7.)

Petitioner contended below that the partnership with the trusts was bona fide and, therefore, that income allocable to the trusts' interests in the alleged partnership was not taxable to him. Following a trial, the district court denied the government's motion for a directed verdict, and the jury answered a special interrogatory favorably to petitioner (Pet. App. C1-C2). This resulted in a judgment for petitioner when the district court denied the government's motion for judgment n.o.v. On appeal, the Fifth Circuit found (Pet. App. A6) that the "undisputed facts and inferences permissible therefrom point so strongly and conclusively against the existence of a bona fide family partnership that reasonable men could not arrive at a contrary verdict." It accordingly reversed and remanded the case with instructions to the district court to enter judgment n.o.v. for the United States.

ARGUMENT

The decision below is correct. There is no conflict of decisions or other occasion for further review.

1. Section 704(e) of the Internal Revenue Code of 1954 (Appendix, *infra*, pp. 9-10) provides that a person (including a trust) may be recognized as a partner in a family partnership if he owns a capital interest in a partnership in which capital is a material income-producing factor, even if that interest was created by gift. That provision, however, does not relax the standards for determining whether the donee actually owns the interest purportedly given or whether, although the transaction is not a sham, the donor has retained so many incidents of owner-

ship that he must continue to be recognized as the actual owner of the partnership interest. *Spiesman* v. *Commissioner*, 260 F.2d 940 (C.A. 9). Thus, in this case, petitioner was required to establish both that capital was a material income producing factor, and that the parties truly intended to conduct a partnership in the substantive sense of the word. See *Commissioner* v. *Culbertson*, 337 U.S. 733.

The court below correctly concluded that petitioner failed to meet either of these requirements. Prior to the partnership's formation, petitioner was conducting a profitable and established optical dispensing business side-by-side with his professional practice. Capital was an insignificant aspect of the business, and customers were derived largely from petitioner's own professional practice. After the formation of the partnership, the optical dispensing business continued as before, unchanged as to location, management, staff, the manner in which it was held out and known to the public, the source of its business and income, and with no services or material amount of capital being provided by the trusts. Because petitioner never gave up his control of the business, and because capital was not a material income-producing factor in the business, the partnership form had no economic reality and was no more than an income-splitting device designed to take advantage of lower marginal tax rates. Under these circumstances, the arrangement cannot be treated as a family partnership for tax purposes.

2. Petitioner contends (Pet. 11) that he was denied his constitutional rights because a jury verdict

in his favor was reversed without oral argument. This contention, made for the first time in this Court, is without merit.

This case was placed upon the summary calendar of the court of appeals to be determined without oral argument only after the observance of a careful procedure designed to safeguard procedural due process. See *Murphy* v. *Houma Well Service*, 409 F.2d 804 (C.A. 5); *Huth* v. *Southern Pacific Co.*, 417 F.2d 526, 527-530 (C.A. 5). The action was taken only after submission of the record and all briefs of the parties, and only after a panel of three active federal judges had agreed that oral argument would not be helpful to them in deciding this particular case. If, after the case was placed on the summary calendar, any member of the panel had any doubts as to the proposed opinion, the case would automatically have been removed from that calendar and set for oral argument. *Murphy* v. *Houma*, *supra*.

In *Communications' Comm'n* v. *WJR*, 337 U.S. 265, 274-277, this Court rejected the proposition that oral argument is constitutionally required, stating (p. 276):

> * * * that the right of oral argument as a matter of procedural due process varies from case to case in accordance with differing circumstances, as do other procedural regulations. Certainly the Constitution does not require oral argument in all cases where only insubstantial or frivolous questions of law, or indeed even substantial ones, are raised. * * *

The process of judicial selectivity followed by the court below in the light of arguments made by the

parties in their briefs satisfied both the demands and underlying spirit of *Communications Comm'n* v. *WJR*, *supra*.[2] Petitioner has not shown that denial of oral argument infringed his constitutional rights or was an abuse of discretion by the court of appeals. See *Groendyke Transport, Inc.* v. *Davis*, 406 F.2d 1158, 1161-1163 (C.A. 5), certiorari denied, 394 U.S. 1012; *Magnesium Casting Co.* v. *Hoban*, 401 F.2d 516 (C.A. 1), certiorari denied, 393 U.S. 1065.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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OCTOBER 1970.

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[2] It is also consonant with the powers delegated to the courts of appeals by this Court in Rule 34(b) of the Federal Rules of Appellate Procedure (Appendix, *infra*, p. 10) that, unless otherwise provided by rule for all cases or for classes of cases, each side will be allowed 30 minutes for oral argument. See also Rules of the United States Court of Appeals for the Fifth Circuit, Rules 17 through 20 (Appendix, *infra*, pp. 10-12).

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 704. PARTNER'S DISTRIBUTIVE SHARE.

* * * *

(e) *Family Partnerships.*—

(1) *Recognition of interest created by purchase or gift.*—A person shall be recognized as a partner for purposes of this subtitle if he owns a capital interest in a partnership in which capital is a material income-producing factor, whether or not such interest was derived by purchase or gift from any other person.

(2) *Distributive share of donee includible in gross income.*—In the case of any partnership interest created by gift, the distributive share of the donee under the partnership agreement shall be includible in his gross income, except to the extent that such share is determined without allowance of reasonable compensation for services rendered to the partnership by the donor, and except to the extent that the portion of such share attributable to donated capital is proportionately greater than the share of the donor attributable to the donor's capital. The distributive share of a partner in the earnings of the partnership shall not be diminished because of absence due to military service.

(3) *Purchase of interest by member of family.*—For purposes of this section, an interest purchased by one member of a family from another shall be considered to

be created by gift from the seller, and the fair market value of the purchased interest shall be considered to be donated capital. The "family" of any individual shall include only his spouse, ancestors, and lineal descendants, and any trusts for the primary benefit of such persons.

Federal Rules of Appellate Procedure:

RULE 34

ORAL ARGUMENT

* * * *

(b) *Time Allowed for Argument.* Unless otherwise provided by rule for all cases or for classes of cases, each side will be allowed 30 minutes for argument. If counsel is of the opinion that additional time is necessary for the adequate presentation of his argument, he may request such additional time as he deems necessary. Requests may be made by letter addressed to the clerk reasonably in advance of the date fixed for the argument and shall be liberally granted if cause therefor is shown. A party is not obliged to use all of the time allowed, and the court may terminate the argument whenever in its judgment further argument is unnecessary.

* * * *

Rules of the United States Court of Appeals for the Fifth Circuit:

RULE 17

DOCKET CONTROL

In the interest of docket control, the chief judge may from time to time, in his discretion,

appoint a panel or panels to review pending cases for appropriate assignment or disposition under Rules 18, 19 or 20 or any other rule of this court.

RULE 18

Summary Calendar

(a) Whenever the court, sua sponte or on suggestion of a party, concludes that a case is of such character as not to justify oral argument, the case may be placed on the summary calendar.

(2) A separate summary calendar will be maintained for those cases to be considered without oral argument. Cases will be placed on the summary calendar by the clerk, pursuant to directions from the court.

(c) Notice in writing shall be given to the parties or their counsel of the transfer of the case to the summary calendar.

RULE 19

Motion to Dismiss or Affirm

Within fifteen days after the appeal has been docketed in this court, the appellee may file a motion to dismiss or a motion to affirm. Where appropriate, a motion to affirm may be united in the alternative with a motion to dismiss. The fifteen-day provision may be waived by the court on proper showing of reasonable excuse for delay in filing a motion to dismiss or affirm, upon such terms and conditions as the court may prescribe, or such waiver may be granted sua sponte on the part of the court.

(a) The court will receive a motion to dismiss any appeal on the ground that the appeal is not within the jurisdiction of this court.

(b) The court will receive a motion to affirm the judgment sought to be reviewed on the ground that it is manifest that the questions on which the decision of the cause depends are so unsubstantial as not to need further argument.

The motion to dismiss or affirm shall be filed with the clerk in conformity with Rule 27 of the Federal Rules of Appellate Procedure.

The appellant shall have ten days from the date of receipt of the motion to dismiss or affirm within which to file a response opposing the motion. Such response may be typewritten and four copies, with proof of service, shall be filed with the clerk. Upon the filing of such response, or the expiration of the time allowed therefor, or express waiver of the right to file, the record on appeal, motion and response shall be distributed by the clerk to the court for its consideration.

After consideration of the papers distributed pursuant to the foregoing paragraph the court will enter an appropriate order.

The time for filing briefs pursuant to Rule 31 of the Federal Rules of Appellate Procedure shall not be tolled or extended by the filing of a motion to dismiss or affirm.

RULE 20

FRIVOLOUS AND UNMERITORIOUS APPEALS

If upon the hearing of any interlocutory motion or as a result of a review under Rule 17, it shall appear to the court that the appeal is frivolous and entirely without merit, the appeal will be dismissed without the notice contemplated in Rules 18 and 19.

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